

Letter of Findings Number: 04-20140603
Sales and Use Tax
For Tax Years 2010-2012

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 requires the publication of this document in the Indiana Register. The document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Out-of-state limited liability company with manufacturing facility in Indiana presented explanatory documents and materials sufficient to show that the company should enjoy an exemption from use tax on purchases of repair and replacement parts for mix towers located in the Indiana manufacturing facility. The company further provided explanatory documents and materials sufficient to show that the company should enjoy an exemption from use tax on items and equipment the company purchased to protect its employees from exposure to hazardous materials present in the company's facility. The company satisfied its burden of proof in providing adequate documentation to verify its position.

ISSUES

I. Sales and Use Tax—Manufacturing Exemption.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-3-4; IC § 6-2.5-5-3; IC § 6-2.5-5-5.1; IC § 6-8.1-4-2; IC § 6-8.1-5-1; [45 IAC 2.2-5-8](#); Dept. of State Revenue v. Caterpillar, Inc., 15 N.E.3d 579 (Ind. 2014); Indiana Dep't of State Revenue v. Rent-A-Center East, Inc., 963 N.E.2d 463 (Ind. 2012); Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991), aff'd 599 N.E.2d 588 (Ind. 1992); Indiana Dep't. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Mumma Bros. Drilling Co. v. Department of Revenue, 411 N.E.2d 676 (Ind. Ct. App. 1980); Indiana Dept. of State Revenue, Sales Tax Division v. RCA Corp., 310 N.E.2d 96 (Ind. Ct. App. 1974).

Taxpayer protests the assessment of use tax on certain of its purchases.

II. Sales and Use Tax— Environmental Exemption.

Authority: IC § 6-2.5-5-30; EPA Air Toxics Website, Trichloroethylene.

Taxpayer protests the assessment of use tax on purchases of items designed to limit exposure to hazardous materials.

III. Sales and Use Tax— Safety Equipment.

Authority: IC § 6-2.5-5-3; [45 IAC 2.2-5-8](#).

Taxpayer protests the assessment of use tax on its purchase of certain items of safety equipment worn by Taxpayer's personnel.

STATEMENT OF FACTS

Taxpayer manufactures polyethylene battery separators for the lead acid battery industry. With headquarters located in North Carolina, Taxpayer operates seven manufacturing facilities, including locations in Indiana and Kentucky. The Indiana Department of Revenue ("Department") conducted an audit review of Taxpayer's business records employing a statistical sampling methodology for Taxpayer's accounts payable expense purchases, and a full review of Taxpayer's capital asset purchases for the 2010, 2011, and 2012 tax years (the "Tax Years"). As a result of the audit, the Department determined that Taxpayer owed use tax for purchases made during the Tax Years. The Department found that Taxpayer had made a variety of purchases on which sales tax was not paid at

the time of purchase nor was use tax remitted to the Department. Taxpayer protested the imposition of use tax related to certain of its capital asset and expense purchases. An administrative hearing was held, and this Letter of Findings results.

I. Sales and Use Tax—Manufacturing Exemption.

DISCUSSION

As a threshold issue, it is Taxpayers' responsibility to establish that the existing tax assessment is incorrect. IC § 6-8.1-5-1(c) provides that, "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind. 2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007). Consequently, a taxpayer is required to provide documentation explaining and supporting the taxpayer's challenge that the Department's position is wrong. "[W]hen [courts] examine a statute that an agency is 'charged with enforcing . . . [courts] defer to the agency's reasonable interpretation of [the] statute even over an equally reasonable interpretation by another party.'" *Dept. of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014). Thus, all interpretations of Indiana tax law contained within this decision, as well as the preceding audit, shall be entitled to deference.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). A person who acquires property in a retail transaction (a "retail purchaser") is liable for the sales tax on the transaction. IC § 6-2.5-2-1(b). Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). In general, all purchases of tangible personal property are subject to sales and/or use tax. An exemption from use tax is granted for transactions where sales tax was paid at the time of the purchase pursuant to IC § 6-2.5-3-4. In certain circumstances, additional enumerated exemptions from sales and/or use tax are available.

The Department found that Taxpayer purchased machinery and equipment without paying sales tax at the time of purchase, and assessed use tax on the purchases. Taxpayer asserts that as a manufacturer of products for batteries, certain of the purchases were exempt under the "manufacturing exemption" in IC § 6-2.5-5-3(b).

Generally, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly, or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8](#)(a). A statute which provides a tax exemption is strictly construed against the taxpayer. *Indiana Dept. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "Exemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of government." *General Motors Corp. v. Indiana Dept. of State Revenue*, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991), *aff'd* 599 N.E.2d 588 (Ind. 1992)(Internal citations omitted). Thus, "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *RCA*, 310 N.E.2d at 101. Accordingly, the taxpayer claiming an exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

IC § 6-2.5-5-3(b) states that "[t]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it **for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.**" (Emphasis added). Thus, the Legislature granted Indiana manufacturers a sales tax exemption for certain purchases, which are for "direct use in direct production, manufacture . . . of other tangible personal property."

In enacting the exemption, the Legislature clearly did not intend to create a global exemption for any and all equipment which a manufacturer purchases for use within its manufacturing facility. "[F]airly read, the exemption was meant to apply to capital equipment that meets the 'double direct' test." *Mumma Bros. Drilling Co. v. Department of Revenue*, 411 N.E.2d 676, 678 (Ind. Ct. App. 1980). The capital equipment "in order to be exempt, must (1) be directly used by the purchaser and (2) be used in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of tangible personal property." *Indiana Dep't. of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520, 525 (Ind. 1983). "The test for directness requires the equipment to have an 'immediate link with the product being 'produced.'" *Id.* Accordingly, the sales tax exemption applies to transactions involving equipment which meets the "double direct" test and is "essential and integral" to

the manufacture of taxpayer's tangible personal property. General Motors, 578 N.E.2d at 401. The application of Indiana's double-direct manufacturing exemption often varies based on a determination of when a taxpayer's manufacturing process is considered to begin, and when it ends.

An exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. [45 IAC 2.2-5-8\(a\)](#). Machinery, tools, and equipment acquired for "direct use in the direct production" is defined in [45 IAC 2.2-5-8\(c\)](#) as "manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process" that have "an immediate effect on the article being produced." Property has "an immediate effect" when it becomes "an essential and integral part of the integrated process which produces tangible personal property." [45 IAC 2.2-5-8\(c\)](#). [45 IAC 2.2-5-8\(d\)](#) excludes pre-production and post production activities by providing that "'direct use in the production process' begins at the point of first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its complete form."

Further, [45 IAC 2.2-5-8\(g\)](#), in part, states:

Component parts of a unit of machinery or equipment, which unit has an immediate effect on the article being produced, are exempt if such components are an integral part of such manufacturing unit. The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required either by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced." Instead, in addition to being essential for one of the above reasons, the property must also be an integral part of an integrated process which produces tangible personal property.

Additionally, [45 IAC 2.2-5-8\(j\)](#) provides:

Machinery, tools, and equipment used in managerial sales, research, and development, or other non-operational activities, are not directly used in manufacturing and, therefore, are subject to tax. This category includes, but is not limited to, tangible personal property used in any of the following activities: management and administration; selling and marketing; exhibition of manufactured or processed products; safety or fire prevention equipment which does not have an immediate effect on the product; space heating; ventilation and cooling for general temperature control; illumination; heating equipment for general temperature control; and shipping and loading.

Accordingly, tangible personal property purchased for use in the production of a manufactured good is subject to sales and use tax unless the property used has an immediate effect on and is essential to the production of the marketable good. Thus, only the property that has an immediate effect on and is essential to the direct production of a marketable good enjoys an exemption.

A. Blender Doors for Mix Towers

Taxpayer asserts that the purchases of blender doors for mix towers that Taxpayer uses in its production line are directly used in and are an integral part of battery paste manufacturing. During the hearing, Taxpayer explained that its process begins with the mix towers, with materials inserted through the subject doors. In response to the Department's request, Taxpayer provided additional documents and images to help display its various manufacturing processes. Pursuant to [45 IAC 2.2-5-8\(h\)\(2\)](#), "[r]eplacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax." Accordingly, a part purchased for the mix towers would be tax exempt to the extent that the mix tower is exempt. The issue becomes whether the mix tower is exempt "manufacturing equipment."

[45 IAC 2.2-5-8\(e\)](#) states:

Tangible personal property used in or for the purpose of storing raw materials or finished goods is subject to tax except for temporary storage equipment necessary for moving materials being manufactured from one (1) machine to another or from one (1) production step to another.

(1) Temporary storage. Tangible personal property used in or for the purpose of storing work-in-process or semi-finished goods is not subject to tax if the work-in-process or semi-finished goods are ultimately completely produced for resale and in fact resold.

(2) Storage containers for finished goods after completion of the production process are subject to tax.

(3) Storage facilities or containers for materials or items currently undergoing production during the production process are deemed temporary storage facilities and containers and are not subject to tax.

Because Taxpayer uses the mix towers to temporarily hold work-in-process, pursuant to [45 IAC 2.2-5-8\(e\)\(1\)](#) the mix towers are equipment that is directly used during the production process qualifying for the "manufacturing equipment" exemption. Therefore, pursuant to [45 IAC 2.2-5-8\(h\)\(2\)](#) replacement parts purchased for the mix towers would also be tax exempt.

B. Repair and Replacement Parts for Mix Towers

Taxpayer asserts that the various parts it purchases to repair its mix towers are directly used in and are an integral part of battery paste manufacturing. Taxpayer asserts that the materials were purchased to repair the mix towers and/or the towers' feed systems and therefore are exempt from sales and use tax. Taxpayer states that Taxpayer feeds raw materials into the mix towers, where Taxpayer weighs or measures the materials and mixes them before expelling the mixture to Taxpayer's extrusion stage. Taxpayer maintains that the paste mixture is work-in-process and is temporarily held in the mix towers. Taxpayer reasons that because Taxpayer uses the mix towers in the manufacturing process, parts purchased for the mix towers are exempt.

As with the blender doors, the Department's analysis looks to [45 IAC 2.2-5-8\(h\)\(2\)](#), which provides that "[r]eplacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax." Accordingly, a part purchased for repairing or upgrading the mix towers would be tax exempt to the extent that the mix tower is exempt. Taxpayer has presented explanation and additional materials sufficient to demonstrate that Taxpayer's mix towers are directly used in and are an integral part of its manufacturing process. Therefore, pursuant to [45 IAC 2.2-5-8\(h\)\(2\)](#) repair parts purchased for the mix towers would also be tax exempt.

C. Upgrades to Machines

Taxpayer asserts that the various purchases to upgrade its mix towers to accommodate processes directed at manufacturing new products should enjoy the exemption from sales and use tax provided in [45 IAC 2.2-5-8\(g\)](#). In response to the Department's request, Taxpayer provided additional documents and invoices to support its assertions.

In addition to the cited regulation, the Department's analysis also again looks to [45 IAC 2.2-5-8\(h\)\(2\)](#), which provides that "[r]eplacement parts, used to replace worn, broken, inoperative, or missing parts or accessories on exempt machinery and equipment, are exempt from tax." Accordingly, a part purchased for upgrading the mix towers would be tax exempt to the extent that the mix tower is exempt. As stated above, Taxpayer has presented explanation and additional materials sufficient to demonstrate that Taxpayer's mix towers are directly used in and are an integral part of its manufacturing process. Therefore, pursuant to [45 IAC 2.2-5-8\(h\)\(2\)](#) repair parts purchased for the mix towers would also be tax exempt.

FINDING

Taxpayer's protest to the imposition of use tax on its purchases of replacement doors for two of Taxpayer's mix towers is sustained. Taxpayer's protest to the imposition of use tax on its purchases of repair or replacement parts for Taxpayer's mix towers is also sustained. And Taxpayer's protest to the imposition of use tax on its purchases of upgrades to Taxpayer's mix towers is sustained.

II. Sales and Use Tax– Environmental Exemption.

Taxpayer's manufacturing process includes the use of trichloroethylene, or TCE. Taxpayer asserts that its purchases of a smoke shack heater and other repair or replacement items limit the exposure of TCE to Taxpayer's employees during the production process.

IC § 6-2.5-5-30, states, in relevant part:

Sales of tangible personal property are exempt from the state gross retail tax if:

- (1) the property constitutes, is incorporated into, or is consumed in the operation of, a device, facility, or structure predominately used and acquired for the purpose of complying with any state, local, or federal environmental quality statutes, regulations or standards; and
 - (2) the person acquiring the property is engaged in the business of manufacturing, processing, refining, mining, or agriculture.
- (Emphasis added).

Per the Department's request, Taxpayer provided additional information regarding its use of TCE, as well as Taxpayer's descriptions of the dangers of, and protective measures needed to reduce, TCE's harmful effects. The Department's review of material control data sheets (MCDS) for TCE verifies Taxpayer's own fact sheets. In addition, the United States Environmental Protection Agency (EPA)'s Air Toxic website's entry for TCE gives descriptions and data confirming the effects documented by Taxpayer's explanation and additional materials. See EPA Air Toxics Website, Trichloroethylene, <http://www.epa.gov/ttnatw01/hlthef/tri-ethy.html> (last visited May 27, 2015).

Taxpayer has provided explanation and additional documents sufficient to support its argument for the manufacturing exemption on its purchases of a smoke shack heater and other repair or replacement items to limit the exposure of TCE to Taxpayer's employees during the production process.

FINDING

Accordingly, Taxpayer's protest to the imposition of use tax on its purchases of these parts to support protective measures in its facility is sustained.

III. Sales and Use Tax– Safety Equipment.

Taxpayer asserts that "safety knives," flame retardant sleeves," "ear plugs," "respirators" and their "replacement filters," and "eye protection" Taxpayer purchased are directly used in and are an integral part of battery product manufacturing because Taxpayer's employees must wear or use these items to carry out portions of Taxpayer's production process.

IC § 6-2.5-5-3 provides an exemption for equipment directly used in the direct production of tangible personal property. In addition, [45 IAC 2.2-5-8\(c\)](#), example (2), describes in relevant part:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt. The fact that such equipment may not touch the work-in-process or, by itself, cause a change in the product, is not determinative.

...

(F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

Again, at the Department's request, Taxpayer provided additional documents, images, and invoices to support its argument for the manufacturing exemption. Taxpayer's production process begins with the mixing and blending of powdered and liquefied chemicals to produce battery components. Taxpayer forms, presses, and rolls sheets of sandwiched materials containing layers of chemical compounds. Taxpayer uses the retractable safety knives to slice the sheets into customer-specified dimensions.

Taxpayer's process also relies on the use of TCE. During production, inhalation of the TCE and other chemicals can cause respiratory damage and other ailments. Further, exposure of TCE and other chemicals to the skin and eyes can cause skin or eye damage. Taxpayer has provided evidence sufficient to show that respirators and their replacement filters, eye protection, flame retardant sleeves, and any other clothing necessary to permit the workers to mix and blend chemicals during the production process are exempt as safety equipment directly used in direct production.

FINDING

The Department sustains Taxpayer on its protest to the imposition of tax on Taxpayer's purchases of safety equipment.

SUMMARY

Taxpayer's protest to the imposition of tax on Taxpayer's purchases of blender drop doors for its mix towers is sustained. Taxpayer's protest to the imposition of tax on its purchases of repair and replacement parts for the mix towers is sustained, as well. Taxpayer's protest to the imposition of tax on upgrades Taxpayer purchases for its mix towers is sustained. The Department further sustains Taxpayer on its protest of imposition of tax on purchases of a smoke shack heater and other repair or replacement items to limit the exposure of TCE to Taxpayer's employees during the production process. Finally, the Department sustains Taxpayer on its protest of

the imposition of tax on Taxpayer's purchases of various items that protect Taxpayer's employees from hazardous materials during Taxpayer's production process.

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